

**Before The  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554**

In the Matter of	)	
	)	
Federal-State Joint Board on	)	CC Docket No. 96-45
Universal Service	)	

**COMMENTS OF  
THE NATIONAL ASSOCIATION  
OF STATE UTILITY CONSUMER ADVOCATES  
ON JOINT BOARD HIGH-COST SUPPORT PROPOSALS**

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**I. INTRODUCTION AND SUMMARY**

The National Association of State Utility Consumer Advocates (“NASUCA”)<sup>1</sup> submits these comments on the four proposals for addressing high-cost universal service support set forth in the Public Notice released on August 17, 2005.<sup>2</sup> The proposals were submitted by several individual members of the Federal-State Joint Board on Universal Service (“Joint Board”) and Joint Board Staff.

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<sup>1</sup> NASUCA is a voluntary, national association of 44 consumer advocates in 41 states and the District of Columbia, organized in 1979. NASUCA’s members are designated by the laws of their respective states to represent the interests of utility consumers before state and federal regulators and in the courts. *See, e.g.*, Ohio Rev. Code Chapter 4911; 71 Pa. Cons. Stat. Ann. § 309-4(a); Md. Pub. Util. Code Ann. § 2-205(b); Minn. Stat. Ann. Subdiv. 6; D.C. Code Ann. § 34-804(d). Members operate independently from state utility commissions, as advocates primarily for residential ratepayers. Some NASUCA member offices are separately established advocate organizations while others are divisions of larger state agencies (*e.g.*, the state Attorney General’s office). Associate and affiliate NASUCA members also serve utility consumers, but have not been created by state law or do not have statewide authority.

<sup>2</sup> FCC 05J-1. Unless indicated otherwise, all citations herein are to orders and filings in CC Docket 96-45.

The proposals address key parts of the universal service conundrum. But there are many other parts of the universal service issue being addressed in this and other dockets. Appendix A hereto is a global summary of NASUCA's positions on this and other universal service matters.<sup>3</sup>

Of highest priority should be the single most important universal service issue confronting the Federal Communications Commission ("Commission") and the Joint Board: the reported decline in the number of U.S. households that have access to a telephone, as shown in the most recent FCC Subscribership Report.<sup>4</sup> This matter was brought to the attention of the Commission and the Joint Board in a letter from NASUCA dated August 11, 2005. This deserves immediate investigation by the Commission and the Joint Board, because it calls into question the entirety of the Commission's universal service efforts, both high-cost and low-income.

Of next priority for the Joint Board and the Commission should be responding to the remand from *Qwest II*.<sup>5</sup> *Qwest II* rejected the Commission's definitions of "sufficient"<sup>6</sup> and of "reasonably comparable,"<sup>7</sup> and, as a result, rejected the overall high-

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<sup>3</sup> This includes the separate question of how universal service funding should be collected from the interstate carriers who are required to contribute pursuant to 47 U.S.C. § 254(f). How the funds are collected is a different issue from how much the funds are; each is essentially independent of the other. One of the four proposals contains a contribution mechanism; NASUCA anticipates that others will also include discussion of the methodology in their comments, so includes that issue in the attachment.

<sup>4</sup> Belinfante, "Telephone Subscribership in the United States (Data through March 2005)," Industry Analysis and Technology Division (rel. May 2005) ("Subscribership Report").

<sup>5</sup> *Qwest Comm's Internat'l Inc. v. FCC*, 398 F.3d 1222 (10<sup>th</sup> Cir. 2005) ("*Qwest I*"). *Qwest II* overturned this aspect of the Commission order issued on remand from *Qwest Corp. v. FCC*, 258 F.3d 1191 (2001) ("*Qwest I*").

<sup>6</sup> *Qwest II*, 398 F.3d at 1235.

<sup>7</sup> *Id.*, 398 F.3d at 1237.

cost funding mechanism for non-rural carriers.<sup>8</sup> These issues must be resolved before addressing proposals for massive changes in the overall high-cost fund.

That being said, as for the four proposals on which comment is now sought, they represent valiant attempts to address the high-cost piece of the universal service fund, not merely -- as it might appear -- searches for new and better acronyms. The four proposals are as follows: A) “The State Allocation Mechanism: A Universal Service Reform Package,” proposed by Joint Board Member Ray Baum, Commissioner of the Oregon Public Service Commission; B) “Three Stage Package for Universal Service Reform,” proposed by Joint Board Member Billy Jack Gregg, Director of the West Virginia Consumer Advocate Division; C) “A Holistically Integrated Package,” proposed by Robert Nelson, former Joint Board member and commissioner of the Michigan Public Service Commission; and D) “Universal Service Endpoint Reform Plan (USERP),” proposed by Joint Board staff members Joel Shifman, Peter Bluhm and Jeff Pursley.

In many respects, the proposals are not crystal clear, being more outline than detailed action plan. The proposals are described in Section III., below. But the following general statements can be made:

First, none of the proposals adequately tie their details to the key tasks of ensuring affordable and reasonably comparable rates.<sup>9</sup> None of the proposals address the key task given to the Commission by *Qwest II*: defining the key statutory terms “sufficient” and “reasonably comparable.”<sup>10</sup> Second, none of the proposals other than Mr. Gregg’s appear

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<sup>8</sup> Id.

<sup>9</sup> Even if one relegates “affordability” to the low-income programs, the proposals all fall short on the reasonably comparable side.

<sup>10</sup> *Qwest II*, 398 F.3d at 1233.

to focus on limiting the size of the Universal Service Fund (“USF”). Indeed, not even Mr. Gregg’s proposal includes a key measure to control the size of the fund supported by NASUCA, that being limiting high-cost support to a single connection per household.<sup>11</sup> Third, other than the Gregg proposal, however, each proposal goes beyond the immediate needs of the fund, often in the course of unjustified radical changes to the fund. As suggested in NASUCA’s comments on intercarrier compensation, the preferred approaches for the FCC are those that improve the current structure without abandoning it entirely.<sup>12</sup>

As previously discussed in this docket,<sup>13</sup> NASUCA’s members are representatives of both those who are intended to benefit from universal service support and those who pay the support. From that perspective, the main task of the Commission in creating high-cost support is to ensure that the support directives of § 254 are implemented properly and efficiently, and are consistent with the statutory principle of sufficiency. As the Commission has previously held, “the principle of sufficiency encompasses the idea that the amount of support should be only as large as necessary to achieve the relevant statutory goal.”<sup>14</sup> In assessing changes to the high-cost universal service fund, the Commission should first “get back to basics” and determine whether the fund is sufficient to meet the purposes of § 254 -- and not necessarily any others.

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<sup>11</sup> See Appendix B. The proposals accomplish a similar goal -- albeit indirectly -- through their state allocation mechanisms, to the extent they provide states “block grants.” In that circumstances, the state will know that adding support to another carrier or its lines will deprive some other carrier of support.

<sup>12</sup> See CC Docket 01-92, NASUCA Comments (May 23, 2005) at 2.

<sup>13</sup> See, e.g., NASUCA ex parte (March 31, 2004); NASUCA Comments (August 6, 2004).

<sup>14</sup> See *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Order on Remand, 18 FCC Rcd 22559 (2003) (“*Order on Remand*”) at ¶ 37.

## II. UNIVERSAL SERVICE PRINCIPLES

There are seven principles, found in 47 U.S.C. § 254(b), on which the Commission and the Joint Board must base universal service policies:

- Quality services should be available at just, reasonable and affordable rates.
- Access to advanced telecommunications and information services should be provided in all regions of the nation.
- Consumers in all regions of the nation, including low-income consumers and those in rural, insular and high cost areas, should have access to telecommunications and information services that are reasonably comparable to those available in urban areas and at rates that are reasonably comparable to rates charged for similar services in urban areas.<sup>15</sup>
- All telecommunications services providers should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service.
- Federal and state universal service support mechanisms should be specific, predictable and sufficient.<sup>16</sup>
- Elementary and secondary schools, healthcare providers and libraries should have access to advanced telecommunications services.
- Any other principles that the Commission and the Joint Board determine to be necessary and appropriate to protect the public interest, convenience and necessity and are consistent with the Telecommunications Act of 1996 (“1996 Act”).

Consistent with this last point, the Commission has adopted one additional principle: that universal service support mechanisms and rules should be competitively and

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<sup>15</sup> See also 47 U.S.C. § 254(i).

<sup>16</sup> Further, such federal support should be explicit. 47 U.S.C. § 254(e). State support need not be explicit. *Qwest II*, 398 F.3d at 1232.

technologically neutral.<sup>17</sup> The Commission’s universal service policies should strike a fair and reasonable balance among all these principles, although, depending on the context, one principle may be important enough to trump any or all the other principles.<sup>18</sup> Unfortunately, the Commission’s definitions of “sufficient” and “reasonably comparable” were reversed in *Qwest II*.

Further, although these principles are those on which the Commission “shall” base its policies, each policy is explicitly phrased in terms of things the Commission “should” do. Other provisions of § 254 are explicitly things the Commission “shall” do, as follows:

- The Commission shall establish the list of services that are included in universal service.<sup>19</sup>
- Every carrier providing interstate telecommunications services shall contribute to the universal service mechanisms.<sup>20</sup>
- Only eligible telecommunications carriers, as defined in 47 U.S.C. § 214(e), shall be eligible to receive federal universal service support.<sup>21</sup>
- Such support shall be used only for the provision, maintenance and upgrading of facilities and services for which the support is intended.<sup>22</sup>

These are the “basics” on which the Commission must base its decisions here and for the rest of the universal service fund.

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<sup>17</sup> See *In the Matter of the Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Report and Order*, 12 FCC Rcd 8776 (1997) (“*First Report and Order*”), ¶¶ 48-49.

<sup>18</sup> *Id.*, ¶ 52.

<sup>19</sup> 47 U.S.C. § 254(c)(1). The Commission shall consider four specific factors in establishing that list. *Id.*

<sup>20</sup> 47 U.S.C. § 254(d). The Commission may require providers of interstate telecommunications to contribute.

<sup>21</sup> 47 U.S.C. § 254(e).

<sup>22</sup> *Id.*



### III. DESCRIPTION OF THE PROPOSALS WITH BRIEF COMMENTS

The following description of the proposals also inevitably includes some comments on the proposals.

#### A. “State Allocation Mechanism”

As its name indicates, the fundamental feature of the proposal by Commissioner Baum in its ultimate form is its allocation of federal high cost funds to the states rather than to carriers, as a “State Allocation Mechanism” or “SAM”. The states will have discretion to allocate their high cost funds, subject to FCC guidelines and review.

The method for allocation will be established by the FCC. The Baum proposal expresses no preference for any specific allocation method, such as the use of a cost model (based on embedded or forward-looking costs) or other methods. However, if a model is used, a statewide average is recommended.

There would also be a statewide rate benchmark. Precisely which rates would be benchmarked is not explained, but the benchmark would “establish an expectation that local consumers would be responsible for the cost of the local network serving them up to a level at which the price of supported services would not be affordable or reasonably comparable, as required by § 254.”<sup>23</sup> It thus appears that the benchmark would be just for supported services. No guidance is given on how the benchmark would be calculated, but it would be subject to periodic adjustment. It is also not clear whether this proposal

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<sup>23</sup> Baum at 4.

would require or would force local rates to increase up to the benchmark amount.<sup>24</sup> That would be interference in any state ratemaking jurisdiction that still remains.

The benchmark would be multiplied by subscriber counts for the state to determine the amount of subscriber revenue that would be expected in that state. This total revenue amount would be compared to the results of the cost model, with -- apparently -- any deficiency from costs picked up by the USF (and “credited to the State’s account at USAC [Universal Service Administrative Company]”<sup>25</sup>).

Despite its lack of basic detail, the proposal contains a six-step plan for transition from the current environment to the final plan, based on the FCC’s decisions on intercarrier compensation. One notable aspect of the transition is that, prior to a phase-in of intercarrier compensation offsets, as of June 2006 universal service distributions are to be frozen, presumably on a state-wide level.<sup>26</sup>

The Baum proposal would, at least for universal service purposes, do away with jurisdictional separation of revenues, plant and expenses. The plan would also allow states to adopt state-specific “increments” to federal support, with funding specific to that state. Yet apparently this funding would come from the interstate revenues that are the source of the federal fund, rather than from intrastate revenues.

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<sup>24</sup> This is also not clear for the two other proposals that include a SAM.

<sup>25</sup> Id. at 5.

<sup>26</sup> The plan does not specify whether the offset would replace all or only a part of the revenues that will presumably be lost in intercarrier compensation reform.

**B. “Three Stage Package”**

Mr. Gregg’s package contains many elements that have previously been proposed or supported by NASUCA, including:

- Combining study areas owned by a single company within each state;
- Moving large rural carriers to the forward-looking cost model;
- Freezing per-line support upon competitive entry;
- Determining support based on each eligible telecommunications carrier’s (“ETC’s”) costs, capped at the level of per-line support of the incumbent;  
and
- Basing smaller rural carriers’ support on their total costs.

All of these items will serve the purpose of controlling the size of the fund.

Mr. Gregg also proposes to extend the FCC’s non-rural carrier “rate comparability review” process -- which allows states to petition for additional support if, despite combined federal and state efforts, rural rates are not reasonably comparable to urban rates -- to rural carriers. NASUCA supported this process for non-rural carriers, and also supports its application to rural carriers.

For the rural carriers whose support continues to be based upon embedded costs, Mr. Gregg also proposes that their unseparated embedded costs be compared to the sum of total actual intercarrier revenues plus a national revenue benchmark. The national revenue benchmark “would represent the local contribution to support of carrier costs

expected of all local customers throughout the nation.”<sup>27</sup> How the benchmark would be calculated is not explained.

Under this proposal, the level of federal support would be based on some percentage (less than 100) of the difference between costs and revenues. This is consistent with current support mechanisms for both rural and non-rural carriers. NASUCA supports maintaining this principle of not supporting all costs above a benchmark (which other of the proposals appear to violate).

The foregoing proposals are parts of Mr. Gregg’s Stage One (“Short-Term Plan”) and Stage Two (“Mid-Term Plan”). It appears that the differentiation is based on the context of the current Joint Board referral,<sup>28</sup> with Stage One covered by the referral and Stage Two requiring new proceedings and comments. NASUCA supports expeditious action to reform the USF, and urges expeditious adoption by the Joint Board and the Commission of the proposals in Stage One, and consideration of the proposals in Stage Two. It appears to NASUCA that these proposals by Mr. Gregg are more directly connected to the statutory purposes of the fund than much of the other proposals put out for public comment here.

Mr. Gregg’s Stage Three (“Long-Term Plan”) is, at this point, too long-term and too undefined to be the subject of detailed comment. NASUCA would note, however, 1) that a “unified” system of support should not mask the real differences among carriers; 2) that to the extent that the plan contemplates a system of “block grants” to the states, it

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<sup>27</sup> Gregg at 11.

<sup>28</sup> Id. at 8. The “current” referral is, of course, the FCC’s referral issued in June 2004. See FCC 04-125, 19 FCC Rcd 11538 (2004) (“*Referral Order*”).

raises issues addressed below in Section IV.C., below; and 3) that annual automatic increases based on changes to the GDP-CPI index -- which is not related to actual telecom costs -- sacrifice the statutory purpose of the USF to simplicity.

### **C. “Holistically Integrated Package”**

Former Commissioner Nelson’s package contains elements of the other packages, and includes elements of the intercarrier compensation proposal submitted by the National Association of Regulatory Utility Commissioners (“NARUC”) Task Force on Intercarrier Compensation (“NTFIC”) in the FCC intercarrier compensation docket (CC Docket No. 01-92), which is referred to as the NARUC Intercarrier Compensation Proposal (“NICP”).<sup>29</sup> As discussed in NASUCA’s comments in 01-92, the massive changes to universal service proposed by NARUC and others were largely unnecessary, and driven by the fundamental revenue guarantees contained in those proposals.

The Holistically Integrated Package (“HIP”) begins, like the Baum proposal and USERP, with a massive shift of USF authority to the states. The states would operate under FCC guidelines that

would address both how to determine what each state receives ... and, in general, how each state would allocate its disbursements within the state. Unlike certain packages, however, the HIP would leave the states with more discretion to distribute the funds in accordance with the guidelines. ... The FCC guidelines would spell out the factors a state could consider in making its distributions (embedded costs, forward looking costs, Lifeline/Linkup participation) but each state would determine the amount

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<sup>29</sup> The Nelson proposal refers to an “Options Memo” circulated by Staff on April 12, 2005. Nelson at 14. The “Options Memo” is not included with the proposal, however.

each carrier receives, provided that the permanent rate benchmark proposed in the NICP (125% of the national urban rate) is honored.<sup>30</sup>

Under the SAM proposed by Commissioner Baum, the FCC would determine how much high-cost funding each state would receive, and the states would determine how to allocate that amount. It appears possible that under the HIP SAM, the states would determine both the total amount of support they will receive, and how to allocate it.

Like the other packages, the HIP includes a transition period, this time of three years. The proposal states that during the transition period “[t]he states would have the authority ... to find that a given carrier should receive less high cost support than what historical levels provided, if the carrier’s earnings levels were unreasonably high or if service quality deteriorated below acceptable levels.”<sup>31</sup> Mr. Nelson’s proposal would also allow the states to adopt a “best practices” benchmark, “to further control the size of the fund.”<sup>32</sup> NASUCA supports these measures and would hope that such actions would also be contemplated beyond the transition in the long-term application of the SAM.

The HIP would do away with the distinction between rural and non-rural carriers, and would base all support on statewide average costs.<sup>33</sup> NASUCA objects to both, as they unreasonably mask the differences among carriers. As discussed below, using Ohio in example, basing support for 400-customer rural Vaughnsville Telephone on statewide

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<sup>30</sup> Id. at 15. As discussed here, the adoption of a rate benchmark (whether at 125% of the national urban rate or at some other level), as discussed below, is one of the “back to basics” steps the Commission needs to take.

<sup>31</sup> Id.

<sup>32</sup> Id.

<sup>33</sup> With regard to the latter, the HIP relies on USERP. See discussion of USERP in Section IV.D.

average costs that include 3 million-customer, predominantly urban, SBC would mean that Vaughnsville's costs would be lost in the rounding.

Another problematic aspect of HIP is its inclusion of a “connections, bandwidth, or numbers based approach” to the USF contribution methodology.<sup>34</sup> The parameters of the high-cost fund in no way dictate or control the contribution mechanism. Further, as discussed in Appendix A, a connection-, bandwidth- or numbers-based mechanism is inconsistent with the statutory framework, burdens customers based on their access to -- rather than usage of -- the interstate network, and is no better able to withstand increases to the fund than is the current revenue-based mechanism.

#### **D. “Universal Service Endpoint Reform Plan”**

USERP addresses support for ILEC ETCs separately from that to be given to CETCs, including wireless ETCs. This is an improvement on the current system, which bases support for CETCs on the ILECs' costs. USERP's CETC provisions are discussed in Section V., below.

Turning to ILEC support first, USERP would use embedded or accounting costs as the basis for determining high-cost support, and would support all operations, “including network operations, customer service operations, and corporate operations.”<sup>35</sup> Yet it would also require calculation of forward-looking costs or the establishment of “best in class” standards, in order to cap the costs that are supported. No explanation is

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<sup>34</sup> Nelson at 18.

<sup>35</sup> USERP at 21.

given as to why forward-looking costs cannot be used in the first instance, or why the use of embedded costs is superior for universal service purposes.

USERP then divides ILEC support into two parts. “Part I support is designed to continue the FCC’s policy of maintaining affordable and comparable rates among states.”<sup>36</sup> Part II support appears to be designed to provide federal support for states where state USF charges “impose significant burdens upon urban ratepayers....”<sup>37</sup> No examples of states where current state USF charges impose such burdens are given. USERP Part II support is discussed separately in Section V., below.

Then USERP, in a bow to the fact that § 254 speaks to comparable and affordable rates, “equate[s] rates with the average unit revenue requirement that a carrier must recover from its customers” and calls this the “Consumer Cost.”<sup>38</sup> Putting aside the fact that this equation ignores the Commission’s consistent determination that it would support “high-cost” areas, leaving to states the determination of “high-rate” areas,<sup>39</sup> USERP then defines “Consumer Cost” as the difference between the carrier’s total cost and its intercarrier revenues. Presumably this “Consumer Cost” would also be calculated as a statewide average.

By including the entire revenue requirement (minus intercarrier revenues) as a “rate” that is supposed to be comparable and affordable, USERP strays far afield from the

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<sup>36</sup> Id. It should be noted that this is not just “the FCC’s” policy; it is the policy of the United States pursuant to 47 U.S.C. § 254 for all federal high-cost programs.

<sup>37</sup> Id. at 23.

<sup>38</sup> Id. at 22.

<sup>39</sup> *First Report and Order*, ¶¶ 199, 203. With the growing level of state rate deregulation, it will increasingly be harder for the FCC to determine whether a high rate is due to high costs or due to freedom from state ratemaking oversight.



idea that universal service support is to be used only to support certain services -- those on the FCC's "basic service" list.<sup>40</sup> At least the current high-cost model is focused on the facilities and operations required to provide those basic services; the USERP proposal would include costs and investment for, *inter alia*, broadband and, presumably, non-regulated services.<sup>41</sup>

Under USERP, the statewide Consumer Cost would then be compared to a benchmark of "125 percent of the nationwide average urban cost (net of intercarrier revenue)."<sup>42</sup> Just how the "nationwide average urban intercarrier revenue" would be calculated is not explained. In any event, "[s]upport to each state would be sufficient to keep the Consumer Cost at or below the benchmark everywhere in that state."<sup>43</sup> It is also not at all clear how this calculation comes any closer to ensuring affordable and reasonably comparable rates for basic services than does the current mechanism.

This is particularly the case because of the SAM included in USERP. This allocation mechanism appears closer to the Baum proposal than to former Commissioner Nelson's. According to USERP, "[s]tates would have first line responsibility to ensure that all customers have rates that are affordable and comparable."<sup>44</sup> Yet many states no longer have regulatory responsibility for the rates charged to telephone customers. (Indeed, in many states, the idea of a "revenue requirement" so central to USERP is a

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<sup>40</sup> 47 U.S.C. § 254(e).

<sup>41</sup> That is, unless "all categories of ILEC costs" (USERP at 21) is deemed to exclude some categories of ILEC costs.

<sup>42</sup> USERP at 22.

<sup>43</sup> *Id.* Actually, given that the Consumer Cost is a statewide average, the Consumer Cost would inevitably be higher than the average throughout much of the state.

<sup>44</sup> *Id.* at 24.

thing of the past.) Of course, neither does the FCC have such responsibility, but USERP places *all* of the actual responsibility for ensuring affordable, reasonably comparable rates on the states. Further, it appears that, in addition to the statewide Consumer Cost that will determine how much support each state receives, there will also have to be a carrier-specific calculation of Consumer Cost performed by the state in order to determine how to allocate its support.<sup>45</sup>

Under USERP, state allocations would be discretionary, with four problematic limitations. First, the distributions should be sufficient to meet the statutory goals. Yet this will mean that the carriers in each state will be in a constant battle with their commissions, because carrier X got Y% of the state share, but carrier A got only B%. Obviously, with the ability to distribute comes the responsibility to defend the distributions.<sup>46</sup> Second, support would not depend on whether the ILEC is classified as a rural or non-rural telephone company.<sup>47</sup> It is not clear if this means that the state commission will not be able to make any differentiation in support based on that factor (or on the size of the company).<sup>48</sup> Third, “distributions should be predictable and should be based on published data and explicit and predetermined calculations.”<sup>49</sup> Essentially, this places much of the responsibility currently undertaken by USAC on each state jurisdiction. And fourth, the state distributions will be constrained by “declining hold-

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<sup>45</sup> See *id.* (in a “[u]niform high cost” situation, the plan would provide “support so that ... each carrier would have an average Consumer Cost below the benchmark....”).

<sup>46</sup> And the carriers will also have the ability to complain to the FCC. *Id.* at 25.

<sup>47</sup> See Section V.A., below.

<sup>48</sup> See Nelson at 15.

<sup>49</sup> USERP at 24.

harmless protection.”<sup>50</sup> The hold-harmless mechanism must be calculated on a per-line basis,<sup>51</sup> while the state allocation is not; application of the hold-harmless provision would thus also require a per-line calculation.

One final point on state discretion: USERP would allow states to “condition support on particular uses, such as requiring the carrier to meet broadband deployment targets in particular exchanges.”<sup>52</sup> Yet unless and until the FCC determines that broadband service is a supported service under 47 U.S.C. § 254(c), the use of high-cost support to fund broadband deployment would violate the explicit requirement of 47 U.S.C. § 254(e) that support be expended only upon the designated services.

A state that wanted to avoid all of this hassle would have an easy out under USERP. USERP proposes that “the FCC ... operate ... a state-specific universal service program in those states that do not establish a state program on their own.”<sup>53</sup> USERP acknowledges that not all states would need state USFs.<sup>54</sup> Thus the FCC would be faced with the prospect of imposing a state-specific program, where needed, in states where the state commission either chose not to or lacked the ability to adopt its own program. Charitably put, quite apart from the question of whether the FCC has the power to adopt a state-specific assessment mechanism,<sup>55</sup> it is not clear why the FCC would be compelled to act in these circumstances.

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<sup>50</sup> Id.; see id. at 23.

<sup>51</sup> Id. at 23.

<sup>52</sup> Id. at 24-25.

<sup>53</sup> Id. at 25. Some states may lack the authority to establish state programs.

<sup>54</sup> Id.

<sup>55</sup> Id.

#### **IV. GENERAL CONCERNS**

NASUCA has three concerns that are common to more than one of the proposals. The concerns are: combining the rural and non-rural mechanisms; the use of embedded costs to determine support levels, except for the smallest rural ILECs; and, regrettably, NASUCA also has concerns with the amount of authority devolved upon the states by the proposals.

##### **A. Combining the rural and non-rural mechanisms**

Former Commissioner Nelson and USERP include combining the rural and non-rural mechanisms as a key point of their proposals.<sup>56</sup> Commissioner Baum holds out that possibility.<sup>57</sup> Mr. Gregg includes it as a long-term goal.<sup>58</sup>

It may be that it is possible to unify the programs to some extent. For now, however, it appears that adding the largest non-rural carriers to the smallest rural carriers cannot help but harm the smallest of the small. The small companies are significantly different from their non-rural counterparts.<sup>59</sup>

The non-rural carriers are, by definition, the largest ILECs in the nation. They serve rural areas in the various states, yet their predominant service areas -- as signaled by the term “non-rural” -- are not rural, and indeed encompass most of the urban, low-cost areas in the states. The Commission should recognize the characteristics of those

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<sup>56</sup> Nelson at 16; USERP at 24.

<sup>57</sup> Baum at 4 (use a single model per state).

<sup>58</sup> Gregg at 12.

<sup>59</sup> That is why, for example, NASUCA proposed, for the meantime, shielding carriers with fewer than 100,000 access lines within a state from the move to basing costs on a forward-looking cost model; indeed, recognizing these differences is behind NASUCA’s proposal that larger rural carriers not be treated the same as non-rural carriers even under forward-looking costs. See NASUCA Reply Comments (December 14, 2004) (“NASUCA RHC Reply”) at 20-21.

companies, and not attempt to adopt a single support mechanism for carriers of all sizes.

The Commission has adopted a different cost-evaluation methodology for the non-rural carriers than for the rural carriers: Non-rural carriers are subject to a cost model that uses forward-looking costs, while the rural carriers' analysis continues to use embedded costs.<sup>60</sup> NASUCA has proposed that larger rural carriers (with more than 100,000 access lines within a state) be transitioned to a forward-looking cost model.<sup>61</sup>

This differential treatment is justified by the significant differences between rural carriers and non-rural carriers. The Rural Task Force paper on "The Rural Difference" authoritatively summarizes these differences, focusing on the characteristics of the rural carriers.<sup>62</sup>

Appendix C highlights some of the characteristics of the non-rural companies. In most states, these companies' rural territory is a small part of the ILEC's operation, dominated by urban and suburban territory. In almost all cases, these companies are affiliates of some of the largest corporations in the country. And in most cases, these local companies produce healthy earnings for their investors.

All of these distinctions support definitions of "sufficient" and "reasonably comparable" for the non-rural carriers that tend to limit, rather than expand, the level of federal universal service support provided to the non-rural carriers. Many of these

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<sup>60</sup> Compare *Ninth Report and Order and Eighteenth Order on Reconsideration*, 14 FCC Rcd 20432 (1999), ¶ 2 to *Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking*, 16 FCC Rcd 11244 (2001) ("*Fourteenth Report and Order*"), ¶ 8.

<sup>61</sup> NASUCA RHC Reply at 20-21.

<sup>62</sup> "The Rural Difference," Rural Task Force White Paper 2 (January 2000) (available at <http://www.wutc.wa.gov/rtf>) ("*The Rural Difference*"); see *Fourteenth Report and Order*, ¶ 17. As shown in *The Rural Difference*, the smaller the carrier, the greater would be its difficulty in adapting to a rate structure that does not include current levels of support from all sources.

carriers clearly have the resources -- on the intrastate level and the interstate level -- to ensure that their rural rates are reasonably comparable to their urban rates, without support from the federal universal service fund.

Moving to the rural side, it is important to recognize why rural rates might tend to be higher than urban rates. The first reason is that many of the direct costs of service in rural areas will tend to be higher than in urban areas.<sup>63</sup> The second reason is that most of the service in urban areas is provided by large telephone companies, which may also serve rural areas. By contrast, much of the service in rural areas is provided by smaller companies. The smaller companies have less of an ability to spread their common and other costs across a smaller customer base without increasing rates to levels that might not be reasonably comparable to those of their larger urban counterparts.

Indeed, it is this ability to spread common costs -- and indeed, all higher costs of service -- across a larger customer base, that underlies much of the current federal support program for non-rural companies. The use of statewide average costs<sup>64</sup> allows larger companies to maintain reasonably comparable rural rates because they are supported by the lower urban costs the company also experiences. For example, SBC Ohio serves considerable rural territory across the state of Ohio.<sup>65</sup> Yet SBC Ohio also serves seven of the eight major metropolitan areas in the state.<sup>66</sup> As a result, SBC Ohio's

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<sup>63</sup> Although there might be exceptions: For example, some of the costs of laying lines in urban areas can be higher, because they involve digging up and repairing streets.

<sup>64</sup> *Remand Order*, ¶ 25. This principle was not reversed by *Qwest II*, which reversed other portions of the *Remand Order*.

<sup>65</sup> See <http://www.puc.state.oh.us/pucogis/statewidemaps.htm>.

<sup>66</sup> *Id.*

*statewide average* costs are low, and no explicit universal service support is needed to ensure comparable rates.

By contrast, in Ohio a small telephone company -- like the state's smallest, Vaughnsville Telephone Company with 400-some access lines in northwestern Ohio -- serves only rural territory, and has only a few customers over which to spread its common costs.<sup>67</sup> Thus for Vaughnsville, rates will tend to be not reasonably comparable to urban rates, unless there is explicit universal service support.

This is true in rural areas of northwest Ohio where conditions are hardly extreme.<sup>68</sup> It is even more true in rural areas in other states, where mountainous conditions or very widely scattered customers make the costs of service significantly higher than a "lower cost" rural company.<sup>69</sup> These costly conditions are also, of course, observed for large non-rural telephone companies like Qwest in Colorado; but, as in Ohio for SBC Ohio, Qwest in Colorado has lower-cost areas to balance out its high-cost areas. Once again, because Qwest's statewide average costs in Colorado are low,<sup>70</sup> no additional explicit support is necessary.

The presumption should be that, unless a larger rural carrier overall has high costs, it does not have a need for federal support in order to keep service affordable and

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<sup>67</sup> See <http://www.puc.state.oh.us/website/telserv3>.

<sup>68</sup> Flat, but not "extremely" so.

<sup>69</sup> For example, Vaughnsville's approximately 400 customers are spread over service territory of less than ten square miles. By contrast, rural carriers in Alaska and Wyoming serve, respectively, areas with 0.58 and 1.25 persons per square mile. *The Rural Difference* at 9.

<sup>70</sup> As shown on Appendix HC16 of USAC's universal service fund projections for the 4<sup>th</sup> quarter of 2005, the average non-rural carrier costs of Colorado and Ohio are virtually the same, \$23.26 per line vs. \$23.27 per line. *Federal Universal Service Support Mechanisms Fund Size Projections for the Fourth Quarter 2005*, USAC (August 2, 2005).

reasonably comparable in the high-cost areas of its territory. High costs, especially high deployment costs, would be reflected in a company-specific forward-looking cost test, as NASUCA discusses below.

As described in NASUCA RHC Reply, a key recommendation is that the Commission move from the current system, which essentially recognizes only two categories of carriers -- rural and non-rural -- to a system that subdivides the rural category according to the significant differences among rural carriers.<sup>71</sup> In the *Fourteenth Report and Order*, the Commission said that the rural mechanism adopted there “strikes the appropriate balance at this time.”<sup>72</sup> It is time to further adjust the mechanism.

*The Rural Difference* shows not only the many differences between non-rural carriers and rural carriers, but the diversity among rural carriers. It should be intuitively obvious that a carrier with 400 access lines would not have much in common with a carrier that had 100,000 access lines, and, of course, have even less in common with a carrier that had a million or two access lines. But *The Rural Difference* specifically shows that, by and large, carriers that serve more than 20,000 access lines have embedded cost characteristics that are not radically different from non-rural carriers (one could say that their embedded costs are reasonably comparable to non-rural carriers).<sup>73</sup> Once below 20,000 access lines, cost structures increase substantially until the smallest carriers (those with less than 1,000 access lines) have embedded operational costs double

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<sup>71</sup> NASUCA RHC Reply at 20-21.

<sup>72</sup> *Fourteenth Report and Order*, ¶ 28.

<sup>73</sup> Indeed, because the comparison in *The Rural Difference* is between rural carriers and all non-rural carriers (including the largest regional Bell Operating Companies), it appears likely that a comparison between rural carriers and the smaller non-rural carriers (like Roseville and Northstate) would show even less of a difference.



and triple those of the average rural carrier, and three or four times those of non-rural carriers.

*The Rural Difference* discusses a range of “operational related variables.”<sup>74</sup> The graphs included in that discussion show commonalities among carriers with 20,000-50,000 lines, with 50,000-100,000 lines and with more than 100,000 lines, in contrast to the 10,000-20,000 lines and the five smaller groups. Commonalities are seen in the following categories: average lines per local switch,<sup>75</sup> loops per sheath mile,<sup>76</sup> total plant (gross) investment per loop,<sup>77</sup> average gross central office equipment (“COE”) investment per loop,<sup>78</sup> average COE transmission investment (gross) per loop,<sup>79</sup> variability in COE transmission investment per loop,<sup>80</sup> average cable and wire facilities investment per loop,<sup>81</sup> and average plant expenses per loop.<sup>82</sup>

The proposals put out for comment by the Joint Board certainly lack detail and justification, but appear to either shoehorn the smallest carriers in with the largest, or aim to treat the largest carriers in the same fashion as the smallest are treated. Neither approach makes sense.

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<sup>74</sup> *The Rural Difference* at 43-57.

<sup>75</sup> *Id.* at 45.

<sup>76</sup> *Id.* at 46.

<sup>77</sup> *Id.* at 47.

<sup>78</sup> *Id.* at 50.

<sup>79</sup> *Id.* at 51.

<sup>80</sup> *Id.* at 52.

<sup>81</sup> *Id.* at 53.

<sup>82</sup> *Id.* at 54.

## **B. Use of embedded costs**

A key point of USERP is the use of embedded costs to assess the need for high-cost universal service support for all carriers.<sup>83</sup> Commissioner Baum holds that out as a possibility.<sup>84</sup> Mr. Gregg would continue the use of embedded costs for the smallest carriers. Only this last is appropriate.

In the *First Report and Order*, the Commission agreed with the Joint Board's recommendation that forward-looking economic costs should be the basis for universal service support because, unlike embedded costs, they provide appropriate incentives for investment, entry, and innovation in the marketplace.<sup>85</sup> Forward-looking cost tests better simulate the results of a competitive market. There are, however, difficulties applying a forward-looking cost model to the smallest rural carriers.

In the *Ninth Report and Order* and *Tenth Report and Order*, the Commission implemented a forward-looking support mechanism for non-rural carriers.<sup>86</sup> The Commission's methodology, based on the forward-looking high-cost synthesis model, has been used to determine support for non-rural carriers since January 2000.<sup>87</sup> The Commission determined that rural carriers should gradually shift to a forward-looking

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<sup>83</sup> USERP at 20. USERP notes the possibility of limits on embedded costs based on forward-looking costs. *Id.* at 21.

<sup>84</sup> Baum at 3-4. It is not clear under the Baum proposal who would have the right to decide which costing analysis -- forward-looking or embedded -- will be used for which carriers.

<sup>85</sup> *First Report and Order*, ¶ 224.

<sup>86</sup> Tenth Report and Order, 14 FCC Rcd 20156 (1999) ("*Tenth Report and Order*").

<sup>87</sup> In order to comply with the directives of the Tenth Circuit Court of Appeals, the non-rural support mechanism was modified by the Commission in October 2003 in the *Remand Order*.

economic cost methodology on a different time-table than non-rural carriers.<sup>88</sup> Proposals to base all support on embedded costs go against this trend, without adequate justification.

The Joint Board has asked if it is possible to design a forward-looking model that would be appropriate to estimate costs for some or all rural carriers.<sup>89</sup> NASUCA has responded in the affirmative.<sup>90</sup> As noted above, the process should begin with the larger rural carriers, those for whom *The Rural Difference* data shows less of a difference from the non-rural carriers for which the forward-looking cost test has been implemented.

It would, of course, be appropriate to continue to review potential improvements to the FCC's Synthesis Model. It has been many years since the Synthesis Model was last substantially revised. It may be that there are now improvements that have been developed in cost modeling that should be considered and be applied to the Synthesis Model. At this point, however, it does not appear that there are any available alternatives that are superior to the FCC's Synthesis Model.<sup>91</sup> It will be especially important, however, to fine tune the model to make it more appropriate for use with rural carriers; these refinements will also make the model more useful for non-rural carriers.<sup>92</sup>

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<sup>88</sup> See *Referral Order*, ¶ 3.

<sup>89</sup> FCC 04J-2, 19 FCC Rcd 16083 (2004) ("*RHCPN*"), ¶ 20.

<sup>90</sup> See NASUCA RHC Reply at 35.

<sup>91</sup> It remains to be seen whether parties will propose alternatives in this proceeding and whether those alternatives will be preferable.

<sup>92</sup> Among the improvements proposed by NASUCA: First, updating customer location files to accurately locate customers and design the network, to allow identification of scale economies that have emerged for rural carriers since 1996. There should be more accurate means of mapping customer locations today so as to better approximate customer locations and the cost of constructing networks to reach such customers. Second, a more granular approach to the inputs is needed. For example, purchasing power and volume discounts (or, more precisely, *lack* of both for smaller carriers) should be factored into the inputs used in the model. Third, overhead costs will also need to be approached granularly.

If these fundamental changes are made, it will then be possible to perform an “outlier” analysis. For example, if results for companies of similar size and geographic description result in outliers that have costs that are very high compared to group averages, further analysis could be undertaken to determine what drives the differences and whether the model needs additional fine-tuning.<sup>93</sup> The existence of outliers was a major concern of the Rural Task Force. An outlier analysis may also be helpful for non-rural carriers.

As discussed above, NASUCA proposed that companies with fewer than 100,000 access lines remain under a support mechanism that considers embedded costs. NASUCA also proposed that the Commission coordinate a detailed study of how to transition small carriers to a forward-looking regime.

Of particular concern are the numerous smaller carriers that receive more than \$20 per month per line in support. Clearly, whether an embedded test or a forward-looking test is used, there should be a differentiation between smaller, rural companies serving areas where deployment costs are not particularly high -- like the flatlands of northwestern Ohio -- and those serving areas like the Rockies or even the Appalachians. And there should also be distinctions between a carrier serving 5,000 lines in 100 square miles and one serving 5,000 lines in 1,000 square miles.

One key part of this study would be the determination of a “best practices” benchmark for small companies’ overhead and other costs.<sup>94</sup> As noted by the Joint Board, there are serious questions about whether the use of embedded costs provides

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<sup>93</sup> The analysis could also examine companies whose costs are very low compared to the group averages.

<sup>94</sup> See ex parte notice by Dr. Lee Selwyn (June 8, 2005) at 4.

appropriate incentives for the carriers to achieve efficiencies.<sup>95</sup> Obviously, the smaller the carrier, the more impact overhead costs will have on each of the carrier's customers. The federal universal service fund should not be required to support inflated overhead costs.

### **C. Authority delegated to states**

As noted, the centerpiece of the Baum proposal is the SAM. It is also the first item in the Nelson proposal and in USERP.

The only reason Commissioner Baum gives for the SAM is that states “would have large incentives to maximize customer welfare by using their allocations in the most efficient way. Every dollar given to one ETC would be a dollar that could not be given to another.”<sup>96</sup> This assumes that the current mechanism, based on non-rural carriers’ statewide forward-looking costs and on rural carriers’ embedded costs, does not distribute support efficiently *within the state*. It appears that any such inefficiencies could more easily be cured by tweaking the models, as accomplished under NASUCA’s proposals. Commissioner Baum’s proposal also shows the merit to NASUCA’s primary line proposal: Where support goes only to the carrier serving the primary line for each customer, every dollar that is given to one ETC would be a dollar that would not go to another.

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<sup>95</sup> RHCPN, ¶ 21.

<sup>96</sup> Baum at 4. Citations to the proposals are to the author and page of FCC 05J-1.

Former Commissioner Nelson's HIP provides a somewhat longer, but no more convincing, rationale.<sup>97</sup> First, HIP says that "[s]tates are in a better position to ensure that USF funds are distributed to where they are needed because they are close to the customers and can provide the day-to-day oversight that is necessary to monitor potential abuse."<sup>98</sup> It may be that some states are better equipped to determine whether their rural customers' rates are affordable and reasonably comparable, but many states have lost -- through statutory or their own regulatory action -- the ability to, for example, order their carriers to perform costs studies. More importantly, many states have lost the ability to require their carriers to lower rates in response to the receipt of federal funds. Of course, the FCC also lacks such abilities with regard to local rates. So it is not clear what, in this context, the "closeness" of state regulators to customers would produce that is superior to the current system.

Next, HIP asserts that:

[I]t is vitally important to provide a predictable support mechanism for carriers. Higher cost and potentially risky infrastructure investment will not take place at appropriate levels if carriers cannot predict with certainty just which investments would be supported through USF money. Rural companies are especially vulnerable, facing risks unlike their urban counterparts. Rural carriers face unique construction/networking challenges with a lower subscription population and a lower price change tolerance, leaving them less margin for financial error. States need the flexibility to address the unique circumstances of rural carriers<sup>99</sup>

NASUCA obviously agrees about the "rural difference." It should be clear, however, that the "flexibility" referred to in HIP is the flexibility to determine that, of the state

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<sup>97</sup> USERP provides no explanation for why its SAM should be adopted.

<sup>98</sup> Nelson at 16.

<sup>99</sup> Id.

allocation, dollars that would otherwise have flowed to one carrier will instead be granted to another. For states like Ohio and Michigan, whose non-rural carriers currently get no USF funding, this will in fact mean that the flexibility is to apportion the dollars *among the rural carriers*, all of whom presumably face the risks correctly identified by former Commissioner Nelson.

In terms of predictability, one wonders how the carriers would view the HIP proposal. Compared to the current system, where each carrier's support is based on costs, or even a system like NASUCA's, where primary line support is based on the carriers' costs and the carriers' ability to retain primary lines, is a system where state regulators have discretion to allocate federal universal service funds any more -- or in fact, less -- predictable? One would imagine that rural ILECs would be nervous about the possibility that a state commission would allocate some of their support to a wireless ETC.

It may be that there are good reasons for the FCC to subdelegate its funding authority to the states.<sup>100</sup> There might be structures under which this would work. Unfortunately, none of the four proposals provides sufficient reason for this massive change.<sup>101</sup> Further, before considering this proposal, the Joint Board and the FCC should

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<sup>100</sup> The SAM is not specifically authorized by Section 254 of the Act, and it is not clear that the FCC possesses the ability to perform such a subdelegation of its USF responsibilities. See *USTA v. FCC*, 359 F.3d 554, 565-568 (D.C. Cir. 2004).

<sup>101</sup> One thing the SAMs apparently do is require the states to allocate a fixed amount of support, thus eliminating the current incentive for states to designate as many ETCs as possible in order to maximize the amount of support flowing into their jurisdiction. Eliminating this incentive can be done in other ways, of course, such as in NASUCA's proposals.

have a clearer idea of how many states would actually have the authority to administer a SAM like those proposed.<sup>102</sup>

## **V. OTHER SPECIFIC USERP ISSUES**

### **A. USERP CETC Support**

USERP's proposal for calculating support for CETCs is acknowledged not to fully address the "problem" of basing CETC support on ILEC support.<sup>103</sup> NASUCA advises the Commission to fully address that problem, by making CETC support based on the CETC's costs, capped at the cost of the ILEC. This is *not* anti-competitive; indeed it is competitively neutral to give each carrier only what it needs to ensure that its rates are affordable and reasonably comparable. The cap at ILEC costs results from the need to avoid subsidizing competition through the universal service fund.

USERP takes different approaches to wireless ETC support and to "other competitive" ETC support. For wireless carriers, USERP would establish a new and separate "Portability Fund" that would be available only to wireless carriers.<sup>104</sup> It appears, in fact, that for wireless carriers the Portability Fund would totally replace wireless carriers' current support; that sounds like fully addressing the problem. One

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<sup>102</sup> It should be recalled that in the intercarrier compensation docket -- with its attendant (but unnecessary) proposals for massive changes to the USF -- at least one commenter referred to the NARUC "block grant" proposal (see Nelson at 14) as "unworkable...." See Colorado Telecommunications Association, Oregon Telecommunications Association and Washington Independent Telephone Association Comments at 35.

<sup>103</sup> USERP at 26.

<sup>104</sup> Id. at 27.



wonders, however, about the lawfulness -- or at the very least, appropriateness under the Commission's "competitively and technologically neutral" policy<sup>105</sup> -- of a universal service program limited to a single type of carrier.

For other CETCs, USERP would require a sub-wire center disaggregation of costs. The sub-wire center areas would receive differential support. Given that it appears USERP would require this for both rural and non-rural carriers;<sup>106</sup> thus in Ohio the almost 700 wire centers of the non-rural carriers would have to be disaggregated. And in Ohio, there would have to be at least 34 wire center disaggregations for the individual small telephone companies. (Notably, Iowa has more than 150 rural telephone companies.) Once again, it would be simpler to continue to base support for each wire center for that carrier's costs within that wire center.<sup>107</sup>

## **B. USERP Part II Support**

Although the proposal as written is not a model of clarity, it appears that USERP proposes "Part II" support in states where the "required" or "imputed" level of state support would exceed \$2 per month.<sup>108</sup> The Part I permanent benchmark of 125 percent of the national average urban cost (net of intercarrier revenue) would be used. But it is not clear how one gets from one to the other. A numerical example would probably have been helpful.

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<sup>105</sup> See Section II., *supra*.

<sup>106</sup> See USERP at 25 ("[t]he plan would apply to all companies, rural and non-rural").

<sup>107</sup> USERP would also apparently require sub-wire center disaggregation for unbundled network element pricing.

<sup>108</sup> *Id.* at 23.

Part II support would only be available in states that had explicit USF programs. But it is also not clear how the mechanism provides any assurance that the “required” or “imputed” level of explicit support exceeds \$2 a month.<sup>109</sup> Arbitrarily using the national average urban cost (\$21.43<sup>110</sup>) as a rate, it would seem that the \$2 a month in state support would represent less than a 10% surcharge. The interstate USF had more than that level of surcharge in all of 2005.<sup>111</sup> This underscores the lack of support for the \$2 figure.

## **VI. CONCLUSION**

NASUCA appreciates the opportunity to continue its support for a high-cost program that meets the statutory requirements. NASUCA will be interested in reviewing the comments of others on the four proposals.

Respectfully submitted,

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<sup>109</sup> Many state USF programs include elements other than high-cost funding. It seems fair to presume that the required \$2 state support would be limited to intrastate high-cost support.

<sup>110</sup> Id. at 22, n. 12.

<sup>111</sup> See Appendix A, Table 1.

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## **APPENDIX A: SUMMARY OF NASUCA USF POSITIONS<sup>1</sup>**

Key issues are the current level of the universal service fund contribution factor (“USF factor”) and the need to restrain the growth in fund levels, while ensuring that the USF is used for the purposes directed by the Telecommunications Act of 1996. In order to preserve and advance universal service,<sup>2</sup> the first task is to preserve it.

NASUCA presents here updated information on the fund requirements and the revenue assessed for the fund. NASUCA continues to support the continued use of interstate and international revenues -- appropriately calculated -- as the basis on which the USF contribution factor is determined.

A key sub-issue of the level of the fund is the current provisions of the rules that support multiple lines of multiple carriers per customer. NASUCA submits that consistent with the Act, federal support should go only to a single line per customer. In this regard, NASUCA strongly supported the recommendation of the Joint Board in the February 27, 2004 Recommended Decision.<sup>3</sup> A separate summary of this specific issue is found in Appendix B.

NASUCA urges the Commission to limit the growth in the USF by, among other things, restraining the support for ETCs generally and for non-primary lines served by ETCs specifically. NASUCA also urges the Commission to continue the collection mechanism that is fairest to the customers who ultimately pay for the USF -- a collection mechanism that is based on interstate and international usage, rather than on mere access to the interstate and international networks.<sup>4</sup>

### **I. UPDATING THE RECORD**

In the interest of a complete record, the following charts and table supplement NASUCA’s February 2003 and June 2003 comments in the contribution methodology phase of this proceeding, and NASUCA’s March 2004 ex parte. The charts and table show, for the last six years, trends in the dollar requirements of the USF, the revenues on

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<sup>1</sup> This summary is based in large part on an update to NASUCA’s ex parte of March 31, 2004 filed in this docket.

<sup>2</sup> 47 U.S.C. § 254(b).

<sup>3</sup> Recommended Decision, FCC 04J-1, 19 FCC Rcd 4257 (2004) (“Recommended Decision”), ¶¶ 56-71.

<sup>4</sup> It is not necessary at this time to seek the legislative changes that would be required in order to assess intrastate revenues for federal universal service purposes. The members of NASUCA have varying views on whether the use of intrastate revenues for federal universal service purposes would be appropriate.

which collections for the USF are based, and the contribution factor applied to interstate and international revenues. For a few quarters, as the fund requirements continued to grow and revenues remained relatively flat, the Commission used surplus dollars from the schools and libraries portion of the fund to suppress the growth in the contribution factor. For example, without the use of these surplus funds, the contribution factor in 2Q04 would have been 9.9%.<sup>5</sup> This has not been necessary since 2Q04, however. By contrast, for 4Q05, the Commission has determined that, due to the impact of Hurricane Katrina, USAC's estimate of revenues (made pre-Katrina) is likely overestimated. The FCC ordered that the factor for 4Q05 remain at the same level as 3Q05.<sup>6</sup>

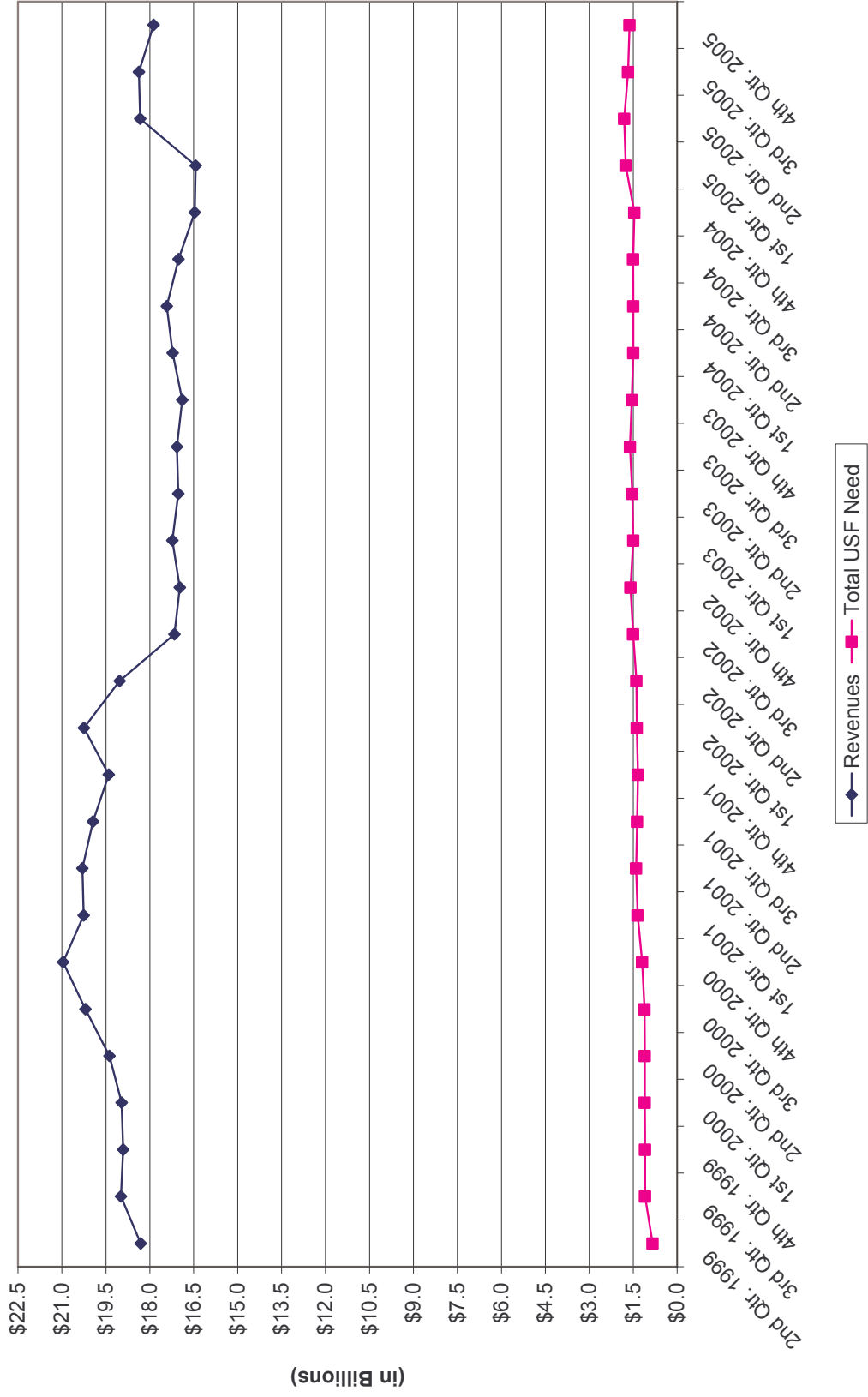
These trends underscore the need for the Commission to bring the fund within control. Means to do so are discussed in the next section.

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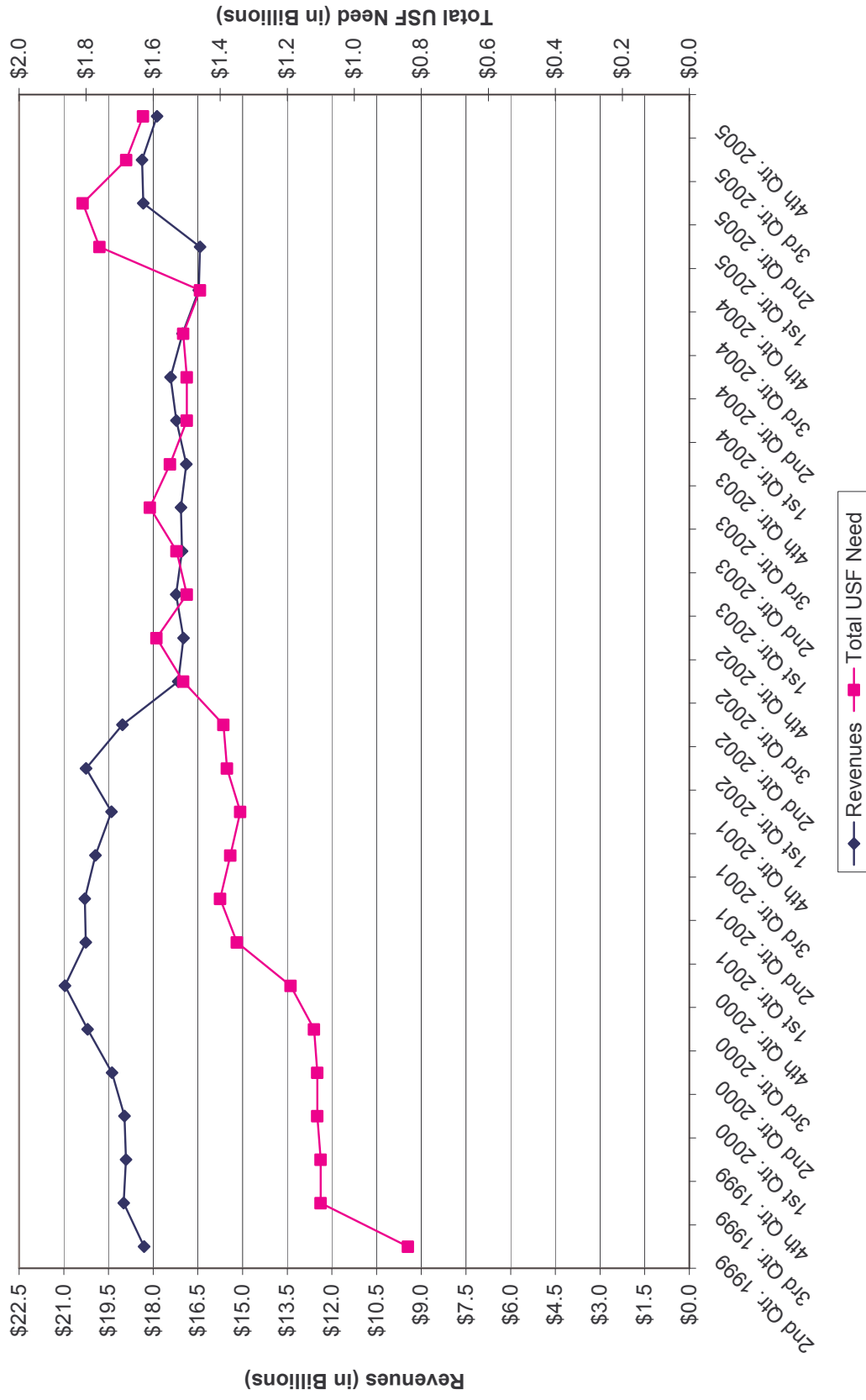
<sup>5</sup> See Public Notice, DA 04-621 (rel. March 5, 2004) (available at [http://hraunfoss.fcc.gov/edocs\\_public/attachmatch/DA-04-621A1.pdf](http://hraunfoss.fcc.gov/edocs_public/attachmatch/DA-04-621A1.pdf)).

<sup>6</sup> See Public Notice, DA 05-2454 (rel. September 15, 2005) (available at [http://hraunfoss.fcc.gov/edocs\\_public/attachmatch/DA-05-2454A1.pdf](http://hraunfoss.fcc.gov/edocs_public/attachmatch/DA-05-2454A1.pdf)).

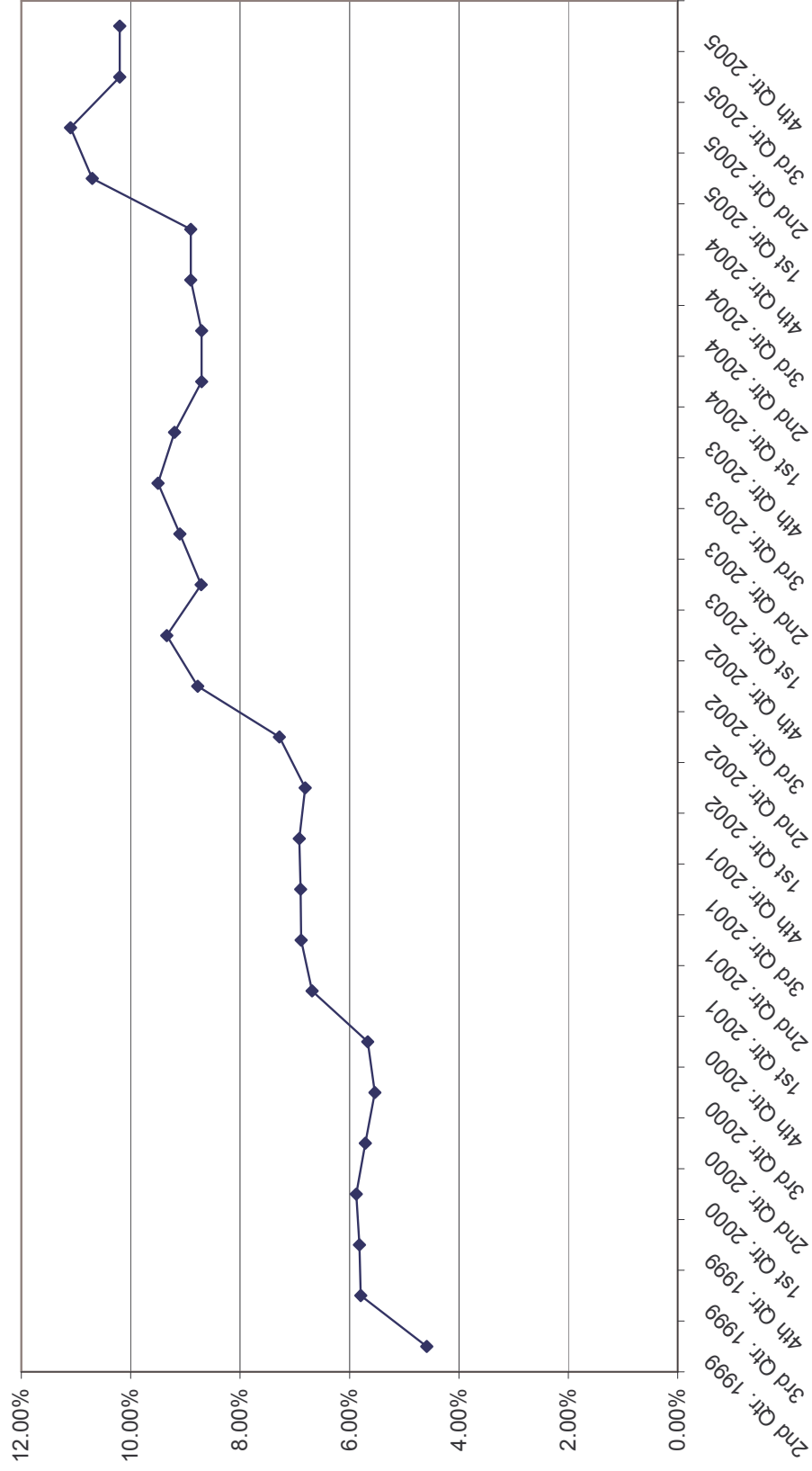
Chart 1



# Universal Service Fund



Universal Service Fund  
Contribution Factor





# Annual Universal Service Fund



**TABLE 1**  
**USF NEEDS AND CONTRIBUTION BASE**

**USF Contribution Fund**

	Revenues	Total USF Need	Contribution Factor
2nd Qtr. 1999	18.31	0.84	0.046
3rd Qtr. 1999	18.99	1.10	0.058
4th Qtr. 1999	18.91	1.10	0.058
1st Qtr. 2000	18.96	1.11	0.059
2nd Qtr. 2000	19.38	1.11	0.057
3rd Qtr. 2000	20.20	1.12	0.055
4th Qtr. 2000	20.96	1.19	0.057
1st Qtr. 2001	20.26	1.35	0.067
2nd Qtr. 2001	20.30	1.40	0.069
3rd Qtr. 2001	19.94	1.37	0.069
4th Qtr. 2001	19.40	1.34	0.069
1st Qtr. 2002	20.25	1.38	0.068
2nd Qtr. 2002	19.03	1.39	0.073
3rd Qtr. 2002	17.16	1.51	0.088
4th Qtr. 2002	16.98	1.59	0.093
1st Qtr. 2003	17.23	1.50	0.087
2nd Qtr. 2003	17.03	1.53	0.091
3rd Qtr. 2003	17.07	1.61	0.095
4th Qtr. 2003	16.89	1.55	0.092
1st Qtr. 2004	17.22	1.50	0.087
2nd Qtr. 2004	17.42	1.50	0.087
3rd Qtr. 2004	17.02	1.51	0.089
4th Qtr. 2004	16.47	1.46	0.089
1st Qtr. 2005	16.43	1.76	0.107
2nd Qtr. 2005	18.33	1.81	0.111
3rd Qtr. 2005	18.37	1.68	0.102
4th Qtr. 2005	17.87	1.63	0.102

Source: Contribution Factor Public Notices.

## II. CONTROLLING THE CONTRIBUTION FACTOR

Absent other action by the Commission, such as the use of surplus funds to increase the revenue base, determining the contribution factor is essentially a simple calculation: The total requirements of the USF are divided by total interstate and international revenues. As a mathematical exercise, then, the factor can be reduced by decreasing the fund requirements in the denominator or increasing the amount of revenues in the denominator, or both.

### A. Increasing the revenues subject to contribution

The contribution base has remained remarkably stable for the last three years. Many parties continue to be concerned, however, about the long-term sustainability of the revenue base.

**Wireless plans and bundling:** One main concern over the level of revenues is the growth of broad wireless plans and the bundling of inter- and intrastate services, which may make the determination of interstate revenues difficult. NASUCA's February 28, 2003 comments offered two solutions to these problems: either the use of a time-tested allocator such as the 25% used for allocating the cost of the local loop, or, indeed, a 100% interstate allocation -- for universal service purposes -- of the revenues from inter/intrastate bundles.<sup>1</sup> This could also work on a carrier-specific basis: If a carrier claimed that it could not determine the percentage of interstate revenue in a bundle, the burden would be on that carrier to demonstrate why 100% of its revenues should not be treated as interstate.

**Broadband and VoIP:** A major concern is the treatment of broadband facilities used for Internet access,<sup>2</sup> and the growth in voice over Internet protocol ("VoIP") service.<sup>3</sup> Earlier this year, the Supreme Court upheld the Commission's determination that cable modem service is an information service.<sup>4</sup> Subsequently, the Commission held

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<sup>1</sup> Consumers Union, et al.'s excellent discussion of the impossibility exception provides specific justification for a 100% allocation. Consumers Union, et al. Comments (April 16, 2003) at 11-16. The Fifth Circuit did not address the issue of bundled services or the impossibility doctrine in determining that the Commission lacked authority to assess intrastate revenues. *Texas Office of Public Utility Counsel v. FCC* ("TOPUC"), 183 F.3d 393, 446-448 (5<sup>th</sup> Cir. 1999).

<sup>2</sup> This includes both digital subscriber line service and cable modem service.

<sup>3</sup> As NASUCA has previously explained, "broadband Internet access service" (as the term is used by the Commission) is really a bundle consisting of a telecommunications service, the broadband "pipe," combined with an information service, Internet access.

<sup>4</sup> *National Cable & Telecommunications v. Brand X Internet Services*, 545 U.S. \_\_\_, 125 S.Ct. 2688 (2005).

that digital subscriber line (“DSL”) service is an information service.<sup>5</sup> As information services that use telecommunications, cable modem service and DSL are both within the Commission’s discretion to assess for universal service purposes.<sup>6</sup> As such, 100% of the revenues from these services should be subject to assessment for the federal universal service fund. The same principle applies to VoIP, especially VoIP that touches the public switched telecommunications network (“PSTN”).

The fact that broadband services do not receive universal service funding is irrelevant to whether they should be required to pay into the universal service fund: First, long distance providers (“IXCs”) do not receive universal service funds, despite the fact that interstate long distance revenues have traditionally been the primary source of funding for the federal fund. Second, many non-rural local carriers receive no funding, despite the fact that they pay into the fund based on their subscriber line charges being considered to be interstate revenues, as well as based on their own interstate traffic. The very nature of the fund dictates, among other things, that there will be imbalances, by industry, by state, and by carrier between amounts paid into the fund and benefits received.

## **B. Controlling the size of the fund**

The total requirements of the fund combine the requirements of the high cost fund (for rural and for non-rural carriers), the schools and libraries fund, the low-income fund and the rural telemedicine fund. NASUCA has proposed strategies to ensure the proper use of the fund and thereby limit the burden on consumers.

We can look at the plan components in terms of their size. Together, the components make up the current \$7 billion fund.<sup>7</sup> The table below shows the growth in the plan segments over time.

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<sup>5</sup> *In the Matter of the Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, CC Docket No. 02-33, et al., Report and Order, FCC 05-150 (rel. September 23, 2005).

<sup>6</sup> 47 U.S.C. § 254(d).

<sup>7</sup> 1Q04 through 4Q04.

**TABLE 5**  
**COMPONENTS OF THE UNIVERSAL SERVICE FUND**  
(\$ millions)  
**Components of the Universal Service Fund (\$ millions)**

Quarterly	<u>Non-rural High Cost</u>	<u>Rural High Cost</u>	<u>Low Income Support</u>	<u>Schools and Libraries</u>	<u>Rural Health Care</u>	<u>Total</u>
1Q2000 (a)(b)	\$58.3	\$436.9	\$124.4	\$491.9	\$2.5	\$1,114.0
1Q2001 (a)	\$218.4	\$448.8	\$164.4	\$527.4	\$1.8	\$1,360.8
1Q2002 (a)	\$214.3	\$468.7	\$158.7	\$559.5	\$4.8	\$1,406.1
1Q2003	\$221.0	\$605.1	\$186.1	\$526.3	\$3.2	\$1,541.7
1Q2004	\$226.1	\$663.4	\$163.3	\$511.7	\$14.7	\$1,579.1
1Q2005	\$259.7	\$717.3	\$195.9	\$822.9	\$11.8	\$2,007.6
Annualized						
Year 2000	\$233.2	\$1,747.6	\$497.6	\$1,967.6	\$10.0	\$4,456.0
Year 2001	\$873.6	\$1,795.3	\$657.5	\$2,109.4	\$7.3	\$5,443.0
Year 2002	\$857.2	\$1,874.6	\$635.0	\$2,238.1	\$19.3	\$5,624.2
Year 2003	\$884.0	\$2,420.4	\$744.4	\$2,105.2	\$12.8	\$6,166.8
Year 2004 (c)	\$904.3	\$2,653.5	\$653.4	\$2,046.7	\$58.6	\$6,316.5
Year 2005	\$1,038.8	\$2,869.2	\$783.6	\$2,250.0	\$47.2	\$6,988.8
Growth from 2000 to 2005	345.45%	64.18%	57.48%	14.35%	372.00%	56.84%
Growth from 2002 to 2005	21.18%	53.05%	23.41%	0.53%	144.36%	24.26%

Source: Contribution Factor Public Notices

In order of size,<sup>8</sup> the components, together with NASUCA's primary recommendations, are:

**Rural high cost** (\$2.87 billion) -- NASUCA's primary recommendation is to restrict support to primary lines (see Appendix B). The Commission should apply rigorous tests to the designation of all ETCs, including competitive ETCs ("CETCs") (see below). The Commission should expeditiously move to a forward looking cost test for rural carriers with more than 100,000 access lines, but small rural carriers should

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<sup>8</sup> 4Q05 annualized.

continue, for now, to have their USF costs based on embedded costs. The Commission should use an ETC's entire operation within a state to determine eligibility for support.

**Schools and Libraries** (\$2.25 billion)<sup>9</sup>: Since its inception, the Schools and Libraries fund has been capped at \$2.25 billion annually. Issues for managing this component were most recently decided in 2004.<sup>10</sup>

**Non-rural high cost** (\$1.04 billion): The Commission should continue to treat non-rural carriers (and large rural carriers) differently. Primary line and CETC restrictions should apply for non-rural carriers as well. The Commission should continue the current practice of statewide cost averaging: Where statewide average cost for a non-rural carrier is below the relevant benchmark,<sup>11</sup> it is appropriate for support to be an intrastate issue. If non-rural carriers are evaluated on a more granular basis, the result would be tremendous growth in the size of the fund or, if the size of the non-rural fund remained limited, extreme dilution of support. Non-rural carriers should be eligible for supplemental federal support if, despite standard federal high cost support and state high cost support, their rates are not reasonably comparable to a national urban average.<sup>12</sup>

**Low income** (\$784 million): The Commission also issued last year a decision on the Lifeline and Link-up programs.<sup>13</sup> Note that the low-income fund demonstrably and directly benefits individual consumers.

**Rural health care** (\$47 million): This component remains minimal. In late 2004, the Commission issued a decision that should give this component greater impact.<sup>14</sup>

**THE HIGH COST FUNDS:** The high cost funds (rural and non-rural) together represent 56% of the fund, up from 44% in 2000; the high cost funds have grown 57% since 2000.<sup>15</sup> The growth in the non-rural fund has been far greater than the rural fund.

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<sup>9</sup> Note that the schools and libraries fund is the slowest-growing component.

<sup>10</sup> *In the Matter of Schools and Libraries Universal Service Support Mechanism*, CC Docket No 02-6, Fifth Report and Order, FCC 04-190, 19 FCC Rcd 15808 (2004).

<sup>11</sup> *Order on Remand*, ¶¶ 49, 64.

<sup>12</sup> The Commission is required to reassess its reasonable comparability standard for non-rural carriers pursuant to *Qwest II*. See 398 F.3d at 1237. That same standard should apply to rural carriers.

<sup>13</sup> *In the Matter of Lifeline and Link-up*, WC Docket No. 03-109, Report and Order, FCC 04-87, 19 FCC Rcd 8302 (2004).

<sup>14</sup> *In the Matter of Rural Health Care Support Mechanism*, CC Docket 02-60, Second Report and Order, FCC 04-289, 19 FCC Rcd 24613 (2004)..

<sup>15</sup> The rural health care fund has had a higher growth rate, but still remains at less than 1% of the entire fund.

Controlling the high-cost segment is obviously the key to controlling the overall fund. There are two key issues for controlling the high cost segment that apply to both rural and non-rural carriers. One is restricting support to primary lines. That is addressed in Appendix B.

**CETCs:** The other issue is competitive ETCs (“CETCs”). The following table shows high cost funding for CETCs and total high cost funding over the last ten quarters:

**TABLE 6**  
**CETC AND TOTAL HIGH COST FUNDING (\$ millions)**

<u>Quarter</u>	<u>CETC Funding</u>	<u>Total High Cost Funding</u>	<u>CETC Funding as % of Total</u>
3Q2003	\$61.6	\$853.4	7.2%
4Q2003	\$62.9	\$857.8	7.3%
1Q2004	\$94.5	\$889.1	10.6%
2Q2004	\$111.5	\$909.6	12.3%
3Q2004	\$133.7	\$942.3	14.2%
4Q2004	\$131.5	\$943.5	13.9%
1Q2005	\$168.9	\$977.0	17.3%
2Q2005	\$182.1	\$992.4	18.4%
3Q2005	\$204.7	\$1,018.8	20.1%
4Q2005	\$202.4	\$1,012.8	20.0%

These numbers show that CETCs are consuming a growing amount of the high-cost fund. In fact, 87% of the growth of the fund over the last two years can be attributed to CETCs.<sup>16</sup> The Commission took a first (limiting) step toward ensuring that the designation of CETCs is in the public interest in *Virginia Cellular*.<sup>17</sup> However, in the more recent generic Report and Order, the Commission failed to apply these standards to state designation of ETCs, merely urging the states to raise the bar.<sup>18</sup> Given that these are federal funds, the Commission should *require* states to follow the federal standards for past and future ETC designations.

For rural carriers, the Commission should also adopt the economic public interest benchmarks proposed by Joint Board member Billy Jack Gregg.<sup>19</sup> Further, in rural carrier

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<sup>16</sup> In 2002, wireless CETCs received \$45 million in high-cost support; in 2003, the number was \$126 million; and in 2004, Wireless CETCs received \$323 million in high-cost support. (Source: USAC Annual Reports.)

<sup>17</sup> CC Docket No. 96-45, FCC 03-338, 19 FCC Rcd 1563 (2004) (“*Virginia Cellular*”).

<sup>18</sup> CC Docket No. 96-45, Report and Order, FCC 05-46, 20 FCC Rcd 6371 58 (2005), ¶ 58.

<sup>19</sup> Mr. Gregg is Director of the Consumer Advocate Division for the State of West Virginia. The proposal was first discussed at the en banc meeting of the Joint Board in Denver, Colorado on July 31, 2003.

areas, the Commission should base support for CETCs on the CETC's cost, but should cap support at the rural ILEC's cost. If the CETC's cost is higher than the ILEC's, support at the CETC's cost would be subsidizing competition.

As previously noted, if all wireless carriers became ETCs this would add \$2 billion (27%) to the Staff-projected 2007 fund. The measures discussed here and in Appendix B will prevent this level of (unnecessary) growth.

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The proposal is that in rural study areas receiving \$30 per line per month in support or more, it should be presumed that only one ETC -- for now, the ILEC -- should be designated. In rural study areas receiving \$20 per line per month or more, but less than \$30 per line per month, it should be presumed that only one ETC in addition to the ILEC should be designated. There should be no presumed limit on the number of ETCs in rural areas receiving less than \$20 per line per month in support.

These presumptive benchmarks are based on the average amount of support for all study areas (\$30.74 per line per month) and the median amount of support for all study areas (\$18.33). These presumptive benchmarks clearly identify high-cost areas where it is not in the public interest to subsidize an unlimited number of ETCs.

Based on data published by USAC, study areas with support of \$20 per line per month or more represent only 1.7% of access lines in the United States, but receive 45% of total high-cost support. Commission data requests in pending ETC applications have attempted to get at some of the same high-cost issues by asking for information, such as customer density in application areas. Support per line data distills all cost-influencing factors -- such as density, distance and topography -- into readily available information.



### III. RETAINING THE CURRENT CONTRIBUTION MECHANISM

#### A. The current mechanism

The FCC Staff Study<sup>20</sup> showed that the current revenue-based mechanism is as sustainable for the near-term as any other of the proposed connection- or numbers-based mechanisms.<sup>21</sup> FCC Staff estimated revenues, program needs, and resultant contribution factors. These are compared to actual experience in the table below:

**Table 4: Staff Projected and Actual Contribution Factors**

Year	Staff Contribution Factor	Actual Contribution Factor
2002	0.080	0.068-0.093
2003	0.093	0.087-0.095
2004	0.096	0.087-0.089
2005	0.100	0.102-0.111

Staff's projections thus appear to be within a range of reasonableness. This increases the likelihood that the two key results of the Staff study are valid: 1) That the three proposed mechanisms increased the burden on residential and small use customers compared to the revenue-based mechanism; and 2) That none of the proposed access-based mechanisms -- based on per-line contributions or per-number contributions -- would be able to weather increases in the fund without concomitant increases in contributions.

The current mechanism is, in concept, both equitable and non-discriminatory, and has been upheld by the courts.<sup>22</sup> There is no need to adopt a radically-different connection-based mechanism that assesses universal service support on carriers and their customers based on access to, not usage of, the interstate network.

Neither increased fund size nor declining revenue base supports the radical change encompassed in the varied proposals of numerous parties for a connection-based

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<sup>20</sup> Public Notice, FCC 03-31, 18 FCC 3006 (2003). The Staff Study was attached to the Public Notice.

<sup>21</sup> See NASUCA Reply Comments (May 16, 2003) at 2, 7-11.

<sup>22</sup> See *TOPUC I*, 183 F.3d at 426-430.

mechanism. The better course, as consistently argued by NASUCA and many others, would be to combine restraint of the fund with further improvements to the revenue-based mechanism.

Equally importantly, the Staff Study does not include any consideration of the costs to the carriers of implementing any of the proposed mechanisms. Given the carriers' complaints about the effort required, and the cost, of minor changes to the current mechanism,<sup>23</sup> the costs of these massive structural changes cannot be ignored.

**B. The results of the Staff Study show that each of the three alternative methodologies unreasonably burdens residential and small business consumers.**

The record is clear that the connection-based methods burden residential and small business customers.<sup>24</sup> These methods, by their very nature, also specifically increase the burden of universal service on low-use customers.

**C. The results of the Staff Study show that each of the three alternative methodologies allows interexchange carriers to avoid responsibility for contributing to the federal USF, contrary to 47 U.S.C. § 254(d).**

The Act directs that all interstate carriers shall contribute to the USF and requires that such contributions be "equitable and nondiscriminatory." 47 U.S.C. § 254(d). As the Staff Study shows, the connection-based mechanisms allow interstate carriers that do not also offer local service to evade almost all responsibility for funding universal service.<sup>25</sup>

**D. The lack of consensus on the mechanisms**

Originally, large ILECs variously supported the current mechanism and each of the three access-based proposals (or variants thereof). Smaller ILECs either supported the current mechanism or one -- and only one -- of the connection-based mechanisms. Wireless carriers either supported the current mechanism or expressed support for one of the connection-based mechanisms as the best of a bad lot. Consumer advocates supported the revenue-based mechanism, except for Ad Hoc, which supported the numbers-based mechanism.<sup>26</sup> AT&T and MCI, the only IXC's commenting, supported two different connection-based mechanisms.

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<sup>23</sup> See CC Docket 96-45 *et al.*, SBC Petition for Reconsideration (January 29, 2003) at 6; *id.*, Verizon Comments on Petitions for Reconsideration (February 27, 2003) at 4.

<sup>24</sup> See NASUCA Reply Comments (May 16, 2003) at 24-26.

<sup>25</sup> *Id.* at 27-29.

<sup>26</sup> The numbers-based mechanism favors the large customers represented by Ad Hoc.

The connections-based mechanisms got another go-round in the Commission's intercarrier compensation proceeding, where carriers proposed hefty increases in the USF either to directly make up for lost intercarrier revenues or to make up for the fact that the revenue would be recovered in local rates, which would then no longer be affordable or reasonably comparable. As demonstrated in NASUCA's comments, however, changes to the contribution mechanism were an attempt to conceal the USF increases. Most importantly, as noted above, the connection-based mechanism is no better able to protect consumers from massive increases in the fund -- such as those proposed in the intercarrier docket -- than is the revenue-based mechanism. And the connection-based mechanism most burdens those who have access to the network but little usage.

Each of the three connection- or numbers-based proposals was opposed by various consumer advocates, wireless carriers, and ILECs.

None of the stakeholders critical of the revenue-based mechanism have shown that their preferred mechanism will be able better to adjust to growth in the fund. This is true for whichever of the three proposals, or variant of the three, they support.

Fundamentally, none of the supporters of a connection-based mechanism explain why it is lawful or reasonable to assess universal service contributions based on access to, rather than usage of, the interstate network.<sup>27</sup> That basic error is reason enough to reject the connection-based proposals. Further, each of the proposals will add to the burden on residential and small business customers, and unlawfully allow many carriers to evade their duty under the law to support universal service.<sup>28</sup>

## **E. Conclusion**

The current revenue-based structure of the contribution mechanism should be retained. Things that *are not* necessary to preserve the federal universal service fund include rate rebalancing, increasing intrastate rates to maximum levels deemed to be affordable, or removing implicit support on the intrastate level.

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<sup>27</sup> See Supplemental Comments of NASUCA (February 28, 2003) at 17-19.

<sup>28</sup> *Id.* at 20-21.

## APPENDIX B: THE USF SHOULD SUPPORT ONLY PRIMARY LINES.

In late 2004, Congress passed, as one provision in a voluminous revenue bill, a provision that forbade the FCC from implementing a rulemaking that would limit support to a single line per customer. That prohibition expires at the end of this fiscal year.<sup>1</sup> By approving this provision in the way it did, Congress was clearly not making a final determination on this issue. For the reasons set forth here, limiting support to a single line per customer is in the public interest and consistent with statutory law.

In comments filed in May 2003, NASUCA noted that the then-current impact on the fund of serving only primary lines would be to eliminate \$350M with the long-run impact being preventing some \$2B in growth in the fund. Under these circumstances, those supporting continuing support for multiple lines per household should bear a heavy burden of persuasion.

**Statutory purpose:** Fundamentally, providing support for multiple lines per household -- whether those are wirelines or wireless connections -- violates the central purpose of § 254 of the Act: that this Commission establish universal service programs to support the basic services designated under § 254(c)(1), and no other services.<sup>2</sup> Section 254(e) says that federal universal support should be used only for the purposes specified in the Act.

Second lines do not meet the test. This is most obviously true for second wirelines, because they do not meet the § 254(c)(1)(A)-(D) tests. They are not vital for the public interest, and they have not been subscribed to by anywhere near a majority of customers exercising their choices in a competitive environment, per § 254(c)(1)(B).

On the other hand, given the number of wireless subscribers, it might be argued that wireless service meets the test of § 254(c)(1)(B) -- being subscribed to by a majority of customers. As the Commission noted in the *Triennial Review Order*, however, wireless service is most appropriately characterized as a supplement to wireline service.<sup>3</sup> The true test under § 254(c)(1) is, therefore, not the total almost 200 million wireless access lines<sup>4</sup> -- most of which are used as supplements to wireline service -- but the small

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<sup>1</sup> There appear to be attempts to revive the prohibition for the next fiscal year.

<sup>2</sup> See § 254(c)(3), which allows the Commission to add other service for schools and libraries and health care providers.

<sup>3</sup> *In the Matter of Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket No. 01-338 et al., Report and Order and Order on Remand, FCC 03-36, 18 FCC Rcd 16978 (2003) (“*Triennial Review Order*”), ¶ 445.

<sup>4</sup> According to the Cellular Telecommunications and Internet Association. See <http://www.wow-com.com/>.

percentage of wireless subscribers who use their wireless phones exclusively.<sup>5</sup> This is no majority of consumers.

**Reasons to support all lines are insufficient:** Proponents of supporting all lines of all networks have claimed that such support is necessary for:

- Supporting entire networks
- Upgrading and building out new networks
- Promoting mobility
- Funding competitive entry.<sup>6</sup>
- Funding new investment opportunities
- Maintaining revenue streams (or ensuring total cost recovery) for small telephone companies<sup>7</sup>

Although these arguments may describe secondary benefits of universal service support, none of these issues touch on the real purpose for the federal universal service funds: providing basic access to all Americans to basic telecommunications services.

Interestingly, both incumbents and competitors oppose limiting support only to primary lines. The ILECs say that a primary line restriction would not be competitively neutral because they would be harmed; wireless ETCs say that the restriction would not be competitively neutral because they would be harmed. The fact is that limiting support to primary lines will ensure that the high cost support system is competitively neutral for all parties, and that all ETCs will compete for the universal service support.<sup>8</sup>

As proposed by NASUCA, when a CETC is designated in a rural carrier's territory, there should be a freeze on the level of per-line support. This, coupled with limiting support to primary lines, will ensure that the presence of a CETC will not *increase* universal service funding, as is currently the case.

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<sup>5</sup> See *Triennial Review Order*, ¶ 445. More recent estimates of wireless substitution have ranged from six to ten percent. See Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services, 19 FCC Rcd 20597 (2004).

<sup>6</sup> *Virginia Cellular* and the FCC order moved away from that purpose.

<sup>7</sup> Means such as those recommended by the Joint Board (see Recommended Decision at ¶¶ 73-80) may be used to ease the transition away from support for multiple lines for rural carriers.

<sup>8</sup> It must be remembered that there will be no competition for universal service support unless and until an additional ETC is designated within a study area. As discussed above, the states and the Commission should restrict the number of ETCs in rural study areas receiving high levels of support.

**Reasonably comparable rural rates:** Those who argue that the USF must support all lines base much of their argument on the Act’s goal that rural services and rates be reasonably comparable to urban services and rates. Because urban customers have access to multiple lines from multiple providers, they argue, so must rural customers.

Many have argued that limiting support to primary lines will automatically or inevitably raise the price of second wirelines in rural areas, resulting in second line prices that are no longer reasonably comparable in price to urban second lines. These arguments overlook a number of key factors:

- Second line service has minimal incremental cost.
- In the recent *Order on Remand*, the Commission determined that rural rates for non-rural carriers that are within two standard deviations of the national average urban rate will be deemed reasonably comparable to urban rates.<sup>9</sup> Using this standard, rural second line rates that are within two standard deviations of the national urban rate for second lines would also be reasonably comparable to urban second line rates.<sup>10</sup> There has been no showing that the withdrawal of federal support from second lines would produce rural second line rates that are in excess of this standard. Despite the specific standard being overturned in *Qwest II*, it does not appear that any reasonable standard would be different in this respect.
- This is particularly so because the rates for second lines remain within the jurisdiction of ratemaking and universal service efforts within the states.

The Act does not direct that rural rates will be equal to urban rates. Rural rates are supposed to be “reasonably comparable” to urban rates. That’s all the law directs.

Others have argued that limiting support to primary lines will limit the growth of wireless service. These arguments are also groundless. First, wireless carriers have historically served rural areas and built out their networks without federal support (as contrasted to ILECs that have always had such support in one form or another).

Second, no one makes the claim that rural wireless customers are entitled to receive service at rates that are reasonably comparable to urban wireline rates. The comparison should be to urban wireless rates. There has been no showing that, if support for second lines is eliminated, rural wireless customers will pay rates that are not reasonably comparable to urban wireless rates. Again, there is no requirement that rural rates be *equal to* urban rates.

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<sup>9</sup> *Order on Remand*, ¶ 38.

<sup>10</sup> Urban second line rates tend to be equal to primary line rates.

Serving a single line per household is competitively neutral. In fact, it appropriately requires carriers to compete in order to receive the universal service support intended for the services defined pursuant to § 254(c)(1).

**Practical issues:** Opponents of a primary line support policy argue that it will be difficult to determine which line is primary and which lines are not. NASUCA believes that customers should be allowed to choose which line is primary for universal service purposes. Allowing the customer to choose is the ultimate expression of the consumer sovereignty that is supposed to apply in a competitive market. It should be recalled that concerns over slamming arise only where customers can choose.

Although there may be practical difficulties in transitioning to a primary line support system, these administrative issues can be overcome. Carriers should be required to submit uniform ballots to customers and retain all returned ballots for future audit. Support for the lines of customers not submitting ballots will default to the incumbent carrier. Customers should be permitted to change primary line designation only once every six months. The primary line for customers submitting multiple ballots should be the first one postmarked. Carriers would report the number of primary lines to USAC on a quarterly basis.

The difficulties in identifying primary lines -- whatever they might be -- do not justify continuing to support all lines. And no one seriously contends that the cost of identifying primary lines outweighs the cost of continuing to support those lines.

In 1996, the Joint Board originally proposed limiting support only to primary lines. Again in 2004 the Joint Board has recommended basing support on primary lines. It is time for the Commission to finally adopt this position, which best carries out the fundamental promise of the Act: affordable access to the public switched network for all Americans -- even those in rural and high-cost areas.

**Conclusion:** As noted above, in 2003, NASUCA estimated that restricting support to primary lines would save the high-cost fund \$336 million (\$293 million in wireline second lines -- being 10% of the wireline total of high-cost support -- and \$43 million for wireless-- being all but 4% of the total wireless support).<sup>11</sup> On the assumption that penetration of wireline second lines has continued to decline, the wireline amount might now be somewhat less (say \$250 million). Yet in 2004, wireless carriers received approximately \$323 million in high-cost funding.<sup>12</sup> Eliminating all but 10% of that amount would save the fund almost \$291 million, for a total savings of \$542 million, an amount representing more than 15% of current total high cost funding.

For the long run, the impact on the fund would essentially be to prevent the estimated \$2 billion in growth that would result from all wireless carriers across the

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<sup>11</sup> See NASUCA Reply Comments (May 16, 2003) at 17-18.

<sup>12</sup> USAC 2004 Annual Report at 26.

country becoming ETCs. Wireless carriers (and other CETCs) that won the customer's primary line selection would receive support; support would be removed from wireline carriers that lost the line, with the net result being a \$2 billion savings for the fund.



## APPENDIX C: INFORMATION ON NON-RURAL INCUMBENT CARRIERS

State	Carrier	Wireline Non-rural Working Loops (a)	% Non-rural Working Loops(a) to Total Working Loops in State (a)	Non-rural High Cost Funding Projected 4Q2005 (b)	% Non-rural High Cost Funding to Total for State 2004 (c)	State Average Cost per line Switched Access Line (d)	Interstate ROR 2004 (e)
Alabama	CenturyTel Bellsouth	280,415 1,834,337	89.65%	\$4,911,754 \$8,724,617	61.04%	\$30.20	15.35-20.31% (f)
Arizona	Qwest	2,530,160	90.42%	\$2,976,420	19.64%	\$20.89	19.03%
Arkansas	Bellsouth	953,638	63.26%	\$1,393,956	18.46%	\$26.68	18.40%
California	Pacific Bell SureWest Tel Verizon (g)	17,022,689 133,707 4,482,443	98.83%	\$2,265,336 \$912,663 \$6,205,032	30.07%	\$17.43	30.96% 14.84% 36.62-39.78%
Colorado	Qwest	2,566,718	94.28%	\$4,951,476	27.11%	\$23.26	30.33%
Connecticut	SBC	2,204,505	98.86%	\$149,334	36.59%	\$22.05	21.70%
Delaware	Verizon	564,508	100.00%	\$63,720	100.00%	\$19.67	29.88%
District of Columbia	Verizon	832,290	100.00%	\$0	n/a	\$14.92	12.10%
Florida	Bellsouth Verizon	6,277,815 2,221,297	78.83%	\$2,520,354 \$6,182,208	47.50%	\$19.87	28.15% 30.93%
Georgia	Bellsouth	3,897,165	81.08%	\$4,038,753	14.04%	\$22.03	12.77%
Idaho	Qwest (g)	495,348	67.19%	\$0	0.00%	\$26.65	35.45%
Illinois	SBC	6,470,450	94.96%	\$0	20.28%	\$20.58	23.74% 22.45-42.94% (f)
	Verizon (g)	770,401		\$2,743,701			

State	Non-rural Carrier	Wireline	% Non-rural Working Loops(a) to Total Working Loops in State (a)	Non-rural High	% Non-rural High Cost Funding to Total for State 2004 (c)	State	Interstate
		Non-rural Working Loops (a)		Cost Funding Projected 4Q2005 (b)		Average Cost per line Switched Access Line (d)	
Indiana	SBC	2,219,943	87.28%	\$0	39.33%	\$23.76	19.70% 23.32-42.42% (f)
Iowa	Verizon (g)	950,284		\$5,234,178			
	Qwest	1,028,347	52.85%	\$124,026	15.03%	\$24.19	29.95%
Kansas	SBC	1,224,632	78.41%	\$129,087	3.62%	\$23.25	28.19%
Kentucky	ALLTEL (g) Bellsouth Cincinnati Bell	430,202 1,147,905 202,048	84.24%	\$3,503,470 \$4,268,320 \$262,088	45.70%	\$29.11	16.61% 20.93% -13.71%
Louisiana	Bellsouth	2,196,551	90.72%	\$2,330,688	13.06%	\$25.16	26.26%
Maine	Verizon	698,325	76.66%	\$479,276	9.79%	\$28.42	16.29%
Maryland	Verizon	3,733,450	99.80%	\$648,225	41.15%	\$18.84	17.24%
Massachusetts	Verizon	3,980,560	99.90%	\$477,933	48.69%	\$18.91	3.70%
Michigan	SBC Verizon (g)	4,966,710 712,765	94.16%	\$0 \$123,021	3.91%	\$23.13	24.41% 14.95%
Minnesota	Qwest	2,004,934	64.19%	\$0	7.50%	\$22.79	24.82%
Mississippi	Bellsouth	1,278,863	91.26%	\$28,355,233	82.76%	\$36.43	17.02%
Missouri	CenturyTel (g) SBC	311,175 2,478,864	81.07%	\$841,878 \$779,829	12.58%	\$23.54	Not Available 20.94%
Montana	Qwest	347,382	66.40%	\$4,214,615	24.79%	\$33.49	34.73%
Nebraska	Qwest ALLTEL	395,465 266,097	77.66%	\$1,390,330 \$965,082	15.71%	\$29.30	28.77% 11.84%

State	Non-rural Carrier	Wireline Non-rural Working Loops (a)	% Non-rural Working Loops(a) to Total Working Loops in State (a)	Non-rural High Cost Funding Projected 4Q2005 (b)	% Non-rural High Cost Funding to Total for State 2004 (c)	State Average Cost per line		Interstate ROR 2004 (e)
						Switched Access Line (d)		
Nevada	Centel SBC	843,298 370,904	91.22%	\$366,651 \$984,339	26.47%	\$19.21		38.11% 24.94%
New Hampshire	Verizon	726,497	91.37%	\$454,614	16.89%	\$23.90		11.48%
New Jersey	Verizon	6,095,951	96.34%	\$0	0.00%	\$18.14		22.20%
New Mexico	Qwest	818,870	81.56%	\$685,920	11.26%	\$25.54		37.41%
New York	Citizens (g) Verizon	410,706 10,858,329	93.32%	\$0 \$1,939,335	16.37%	\$19.65		21.46% -4.02%
North Carolina	Bellsouth North State Verizon	2,362,747 127,044 346,174	58.10%	\$2,477,448 \$1,155,126 \$2,521,344	37.31%	\$22.98		20.93% Not Available 4.44-12.67% (f)
North Dakota	Qwest	189,857	40.22%	\$132,021	12.05%	\$25.01		42.14%
Ohio	ALL TEL (g) Cincinnati Bell SBC Verizon	134,084 736,349 3,903,288 910,996	85.37%	\$0 \$0 \$0 \$2,066,223	21.51%	\$23.27		Not Available 32.66% 17.49% 18.21%
Oklahoma	SBC	1,469,349	78.06%	\$0	4.52%	\$24.43		35.03%
Oregon	Qwest Verizon	1,304,393 444,636	86.54%	\$642,957 \$3,358,164	23.76%	\$24.06		26.22% 34.70%
Pennsylvania	Verizon (g)	6,255,468	80.72%	\$3,172,200	6.98%	\$20.24		20.31-24.29% (f)
Rhode Island	Verizon	549,546	100.00%	\$9,972	100.00%	\$20.24		5.01%

State	Non-rural Carrier	Wireline Non-rural Working Loops (a)	% Non-rural Working Loops(a) to Total Working Loops in State (a)	Non-rural High Cost Funding Projected 4Q2005 (b)	% Non-rural High Cost Funding to Total for State 2004 (c)	State Average Cost per line		Interstate ROR 2004 (e)
						Switched Access Line	(d)	
South Carolina	Verizon (g) Bellsouth	175,709 1,422,703	70.10%	\$1,472,091 \$1,277,343	14.80%		\$25.64	42.79% 20.15%
South Dakota	Qwest	219,501	50.96%	\$400,665	10.70%		\$28.87	21.31%
Tennessee	Bellsouth	2,496,477	77.16%	\$1,697,316	13.30%		\$25.62	19.98%
Texas	SBC Verizon	9,116,910 1,613,210	88.86%	\$0 \$5,700,051	18.58%		\$21.30	11.55% 12.14-18.29%
Utah	Qwest	994,767	94.25%	\$298,599	4.93%		\$20.65	25.90%
Vermont	Verizon	349,788	81.53%	\$2,549,959	41.86%		\$30.73	14.03%
Virginia	Verizon (g)	3,912,042	85.92%	\$10,283,550	66.02%		\$21.22	25.55-55.21%
Washington	Qwest Verizon	2,328,093 844,941	87.32%	\$658,317 \$4,325,190	33.94%		\$21.07	33.95% 31.55-34.20%
West Virginia	Verizon	821,887	81.22%	\$7,508,059	48.13%		\$30.90	21.08%
Wisconsin	SBC Verizon	1,946,471 391,941	65.39%	\$0 \$0	7.13%		\$22.56	26.21% 12.09%
Wyoming	Qwest	244,238	77.33%	\$3,380,151	43.97%		\$33.20	49.48%

(a) Universal Service Administrative Company - High Cost Loop Support Projected by State by Study Area; Fourth Quarter 2005; Appendix HC05 4Q2005.

(b) Universal Service Administrative Company - High Cost Support Projected by State by Study Area; Fourth Quarter 2005; Appendix HC01 4Q2005.

(c) Universal Service Administrative Company 2004 Annual Report; High Cost Support by State, 2004; page 28.

(d) Universal Service Administrative Company, High Cost Model Support Projected by State, Fourth Quarter 2005; Appendix HC16, 4Q2005.

(e) ARMIS Reports 43-01, Table 1, 2004.

(f) Range of several non-rural reporting companies.

(g) Excludes carrier affiliates which are rural, but which under NASUCA's proposal, would be included as a non-rural carrier and would lose its rural high cost funding.